

Service Date: September 21, 1981

DEPARTMENT OF PUBLIC SERVICE REGULATION  
BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MONTANA

IN THE MATTER of the Application of	)	UTILITY DIVISION
MOUNTAIN STATES TELEPHONE AND TELEGRAPH)	)	
COMPANY for Approval of Tariffs To Im-	)	DOCKET NO. 81.1.12
plement the Variable Term Payment Plan	)	
in Conjunction with DIMENSION and	)	ORDER NO. 4840
HORIZON product lines.	)	

APPEARANCES

FOR THE APPLICANT:

J. Walter Hyer, III, Attorney at Law, 600 North Park Avenue, Helena, Montana 59601,  
appearing on behalf of the Applicant

Laura D. Ford, Attorney at Law, 931 Fourteenth Street, Denver, Colorado 80202,  
appearing on behalf of the Applicant

John Alke, Attorney at Law, Hughes, Bennett, Kellner & Sullivan, 406 Fuller Avenue,  
Helena, Montana 59601, appearing on behalf of the Applicant

FOR THE PROTESTANT:

James C. Paine, Montana Consumer Counsel, 34 West Sixth Avenue,  
Helena, Montana 59620

John Allen, Consumer Counsel Staff Attorney, 34 West Sixth  
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FOR THE INTERVENORS:

Roger Tippy, Attorney at Law, 2031 11th Avenue, Helena, Montana 59601, appearing on behalf of Executone Systems of Montana

Alan L. Joscelyn, Attorney at Law, P.O. Box 1721, Helena, Montana 59601, appearing on behalf of Telephone Answering Services of the Mountain States, Inc.

Dennis R. Muncy, Attorney at Law, 1400 Anthony Drive, Champaign, Illinois, appearing on behalf of Telephone Answering Services of the Mountain States, Inc.

FOR THE COMMISSION:

Calvin K. Simshaw, Staff Attorney, 1227 11th Avenue, Helena  
Montana 59620

BEFORE:

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GORDON E. BOLLINGER, Chairman

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JOHN B. DRISCOLL, Commissioner

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HOWARD L. ELLIS, Commissioner

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CLYDE JARVIS, Commissioner

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THOMAS J. SCHNEIDER, Commissioner

FINDINGS OF FACT

Background.

1. On October 1, 1980, as part of a nationwide Bell System filing, the Mountain States Telephone and Telegraph Company (Mountain Bell, Applicant, Company) filed with the Montana Public Service Commission (Commission) tariff sheets designed to completely restructure the DIMENSION PBX service offerings. Under the filing the existing Two-Tier Payment Plan applicable to the DIMENSION product line would be grandfathered to Section 58 of the General Exchange Tariff (Companion and Two-Tier Payment Plan - Obsolete Services) and the entire product line would henceforth be offered under the Variable Term Payment Plan (VTPP).

2. On January 15, 1981 Mountain Bell filed tariff sheets to introduce the HORIZON VS and to restructure the entire HORIZON tariff under the VTPP, grandfathering the existing Two-Tier Payment Plan option for this product line.

3. Under the grandfathering procedure existing DIMENSION and HORIZON customers would be allowed to grow to the capacity of their existing systems and would be able to add services and features currently available to them.. However, all new feature enhancements, beginning with those included in the filings grandfathering the Two-Tier option, would only be offered under the VTPP.

4. A Notice of Opportunity for Public Hearing addressing this matter was issued on February 19, 1981. On March 11, 1981 Executone Systems of Montana (Executone) filed a Request for Hearing in this matter. Executone is a Montana corporation involved in the vending of terminal equipment telecommunications products. As such it is in direct competition with Mountain Bell for the terminal equipment segment of the telecommunications market.

5. A Notice of Prehearing Conference was issued by the Commission on April 1, 1981; the conference was held in the Commission offices on April 10, 1981.

6. The Procedural Order in this docket was issued May 19, 1981. That order provided that the VTPP issue would be heard by the Commission during the course of the hearing of Docket No. 80.12.100, Mountain Bell's general rate case. The Notice of Public Hearing for the Mountain Bell general rate case and the VTPP Docket was issued on May 18, 1981. That hearing commenced on the 9th day of June, 1981 and concluded June 18, 1981 .

## VTPP vs. Two-Tier Payment Plan

7. The Two-Tier Payment Plan is in essence a two-part tariff containing two elements or tiers of price identified as Tier A and Tier B. The Tier A rate, which is designed to recover the capital costs associated with any piece of capital equipment, can be paid over a payment period selected by the customer from several options (usually three, five, seven or ten years), or may be paid in a lump sum.. The Tier B rate reflects the monthly operating expenses associated with the equipment.

The monthly rate is the sum of the Tier A rate plus the Tier B rate until the end of the Tier A payment period, at which time the monthly payment becomes the Tier B rate only. Termination of service prior to the end of the Tier A payment period results in a termination charge equal to the present value (discounted at 6%) of any unpaid Tier A rates.

8. The VTPP allows customers to pay a single, monthly fixed rate for equipment and service over one of several optional payment periods. A different monthly rate applies for the duration of each period with the rate varying inversely with the length of the payment period. With DIMENSION 100 the payment period options are 1 month, 48 months, and 72 months; the remainder of the DIMENSION product line has 1 month or 48 month options. The only payment period available for software is the 1 month period.

For DIMENSION PBX service the termination charges are as follows:

<u>Variable Term Option</u>	<u>Termination Charge</u>
1 month	None
48 months	24 months of payments or 60% of the remaining
<u>Variable Term Option</u>	<u>Termination Charge</u>
	amount due, whichever is less
72 months	36 months of payments or 60% of the remaining Amount due, whichever is less.

9. Rates under the VTPP and the Two-Tier Payment Plan are subject to change at the discretion of the Montana Public Service Commission.

The Variable Term Payment Plan - A Discussion of the Issues

10. The great majority of evidence addressing the propriety of the Variable Term Payment Plan was obtained during the course of cross-examination that occurred during the combined hearing of Docket Nos. 80.12. 100, Mountain Bell's general rate case, and 80.12. 12, the VTPP case. Testimony pertaining to VTPP was presented by three principal witnesses: Dr. John W. Wilson, witness for the Montana Consumer Counsel; Mr. Richard D. Reinking, witness for the Applicant; and Mr. Keith Money, witness for intervenor Executone Systems of Montana.

11. The prominent issues of concern emanating from the proposed implementation of the VTPP include the effects of the plan on revenue generation and competition and the extent to which the plan contains elements of a discriminatory nature. The appropriate method of pricing terminal equipment to be marketed under VTPP is not a contested issue. It is understood and agreed to by all parties involved that: the Montana Fully Distributed, Cost Methodology sets the floor price for the sale or lease of all Bell System equipment in Montana, regardless of the payment plan subscribed to.

12. Less clear is the impact on revenue generation that occurs as a result of implementing VTPP. As acknowledged by Mr. Reinking, these effects are pretty much unknown:

Q. Does the Variable Term Payment Plan, in and of itself, generate additional revenues?

A. I don't believe it will. I think that it's pretty much a trade-off with the Two-Tier.

Q. Then it's not an application for a rate increase?

A. No, I don't view it as such.

Q. Do you have any studies or empirical data which was applied to inventories that shows there's no revenue increase?

A. No, we don't and you can't do such a thing because, as was discussed earlier, some of the products are different; they are not even offered under Variable Term and so on. (Tr., pp. 1415, 1416.)

The revenue effect is particularly unclear in situations where customers make a transition from the Two-Tier Plan to the VTPP concurrent with upgrading or selecting an alternative payment period, i.e., the one month option.

13. At the heart of the Variable Term Payment Plan controversy is the effect of the plan on competition. The Federal Communications Commission has recently decided that it is no longer necessary to formally regulate the terminal equipment offerings of otherwise regulated telephone companies. DIMENSION ( and HORIZON products are AT&T's current "flagship" vehicles in the area of terminal equipment offerings. These are also the product lines the Applicant is requesting to provide under the VTPP.

14. In those instances where regulation by the market is considered appropriate it becomes imperative that regulators, in facilitating the transition from regulation to competition, limit to as great an extent as possible all barriers to entry in order to insure "robust" competition. Dr. Wilson has argued that there are elements of the Variable Term Payment Plan that serve to imperil the robustness of competition in the vending of terminal equipment. He begins by distinguishing the VTPP from the most frequently used, currently tariffed Two-Tier Payment Plan noting that the plans

...are close, although the Variable Term Pricing Plan has some distinctions that are different than Two-Tier. For example, whereas under Two-Tier, the customer had, in effect, a contractual requirement to pay off the plant that was installed. And depending upon the AT&T jurisdiction, little or no credit if he wished to move from one piece of equipment to another, and say the piece of equipment installed on his premises had become technologically outmoded.

He, of course, had no title to that equipment, unlike the situation which he would buy equipment from an independent vendor, so he could not resell.

But basically he was locked into that particular piece of equipment over the period of his contract. And indeed if he had a contract, would pay it off, the equipment costs, over a short period of time.

As an economic proposition, he was probably locked into that equipment over a further period because he would have, in effect, made the payments for the equipment up front, and it would be an economically costly move for him to shift to some other type of equipment, given the fact that all he was faced with from that point forward was just the variable, the O&M portion of it--of the costs.

Under a Variable Term Plan, as I understand it, the customer has increased flexibility with regard to shifting to new vintages with regard to shifting to new technology as that technology becomes available. So, for example, if a customer

subscribes to PBX service from Mountain Bell at the present time for, say, DIMENSION or HORIZON, and enter into a Variable Term contract, I understand that under that contract, when AT&T comes out with, for example, the ANTELOPE switch, the customer will have the liberalized provision for shifting to the newest technology on the basis that does not include the type of cost penalties that would have been involved under a two-tier contract.

So in effect, under the Variable Term Payment Plan, the customer does have a contractual obligation with Mountain Bell, but that contractual obligation has flexibility in that it permits the customer to move up in the technological scheme of things as AT&T makes new technology available, which, of course, is attractive from the customer's point of view, having been locked into Bell equipment in the first place.

But it makes things particularly difficult for competitive vendors, because although there are liberalized provisions for customers to move up to technology that is offered by Mountain Bell or offered by AT&T System, he doesn't have that flexibility should he wish to make a shift to technology or equipment that might be offered by Exxon or by Xerox or some other competitive vendor in the future. (Tr., pp. 1134-1137.)

15. Corroborating Dr. Wilson's view that the VTPP may contain anti-competitive elements is the testimony of Mr. Money. When asked what areas of the proposed VTPP Executone of Montana, as a competitor of Mountain Bell, objects to most strongly he responds:

A. I believe there are two main areas that we as competitors of Mountain Bell find objectionable in the new product that is offered as Variable Term. The first area lies in the ability of the Telephone Company to take an existing client of theirs that is under a Two-Tier arrangement using a particular piece of equipment, and without penalty take that customer into a new pricing arrangement, the Variable Term Pricing arrangement, and thus be able to perpetuate their relationship with that customer, whereas the customer would have to face a penalty if he wanted to go with a private competitor. By assessing no penalty to allow him to migrate into a Variable Term contract, whereas a penalty would be assessed to him should he want to break that Two-Tier to go with competitor products, I believe there is discriminatory features inherent in the Variable Term offering .

Q. What would you suggest as the solution, an evenhanded and equitable solution to that threatened discrimination?

A. I would suggest that either a penalty be charged any time a Two-Tier contract is broken before its Tier-A has been completely paid off, and that would include going to a Variable Term contract, or else no penalty at all is assessed for breaking of that Tier-A contract whether that customer desires to go into a new Variable Term contract or whether he would desire to go to a competitor's product.

Q. You mentioned two major areas of concern. What would the other one be?

A. The other area of the Variable Term which we believe has again been put into this pricing plan mainly from the standpoint of trying to continue the relationship of existing customers with the Bell System in making it economically unfeasible for them to break that relationship is the concept of recasting. In some periodicals it's also called reupping.

Q. Would you explain those terms in lay language to us?

A. Really what it gets down to is if a client has a Variable Term contract that's active with the Telephone Company, any time during that term of the contract, let's assume 48 months, the Telephone Company can come to him for a number of reasons, either we have some new features to offer you or it appears that rates may be going up and it would be wise for you to maybe extend your contract, but for various reasons they can go to their client that has the Variable Term contract and suggest that if he is two years into it, maybe he should extend this contract for another four years.

In essence what it allows them to do, then, is to perpetuate that contract with their customer effectively taking him out of the marketplace maybe for not just the four years, but maybe eight, ten, twelve years as new offerings come down, because there is no penalty for him to simply renew that contract.

And since most new systems appear to be software oriented rather than hardware oriented, the HORIZON and DIMENSION system we see today might be a completely different animal four or five years from now, not just because the hardware has been redesigned or remanufactured, simply because enhancements have come out in the software.

So once they do have a client under a Variable Term contract and are able to go to him and talk about recasting and enhancing and renewing the contract, it could very well be that the customer will never be back in the competitive marketplace simply because it would be uneconomical for him to break that Variable Term contract to go seek competitive equipment. (Tr., pp. 1453-1456.)

During the course of cross-examination it became apparent that the Applicant was arguing from the grounds that 1) entering a leasing arrangement with AT&T was essentially no different than entering a leasing arrangement with any of the independent vendors, hence "lock-in" could equally be achieved by both parties; and 2) because the VTPP option generally contains shorter lease lives( than those available under the Two-Tier arrangement that moving to VTPP was moving away from locking in the customer. In addressing alternative leasing arrangements Dr. Wilson noted that, in fact, there are substantial differences between leasing from AT&T and leasing from the independents:



Q. If I understand the comment that you made earlier correctly, I would interpret the term "lock-in" to be equivalent to a customer signing a letter of agreement for Bell System equipment, be it on a Two-Tier or a Variable Term is that a true statement?

A. Well, I haven't reduced it to a particular act, but generally, it's anything that economically commits a customer to a particular vendor over an extended period of time and thereby effectively removes him as a buyer from the competitive marketplace.

Q. As a businessman, if I were on the market for a large switcher and I signed a contract or an agreement with Rolm, would you consider that to be a lock-in as well, sir, in your terminology?

A. No, not in the same way. If you were to buy a switch from Rolm, take title to -- It's like buying a car. And next year if you decide you want another car, you can go ahead and sell it. There's a substantially secondary market.

You can sell that PBX to somebody else and buy something that fits your needs at that particular time. Conversely, if you enter into a four-year contract with AT&T and in two years you decide you want something else, you haven't got title to that equipment; you can't sell it, and you take a bath.

And there's a big difference between purchasing a piece of equipment that can be resold and maintaining that type of economic protection or flexibility, if you will, and entering into a contract that says, "Here I am, I'm yours for the next four years unless you come around with something that's better." In which case, I have the option of switching into your newest vintage that's available. That's a little bit different. And I would characterize the one as a lock-in and not characterize the other as a lock-in.

Q. And the basis for that distinction is the difference between sale and lease, is that correct? Do I understand that correctly?

A. Well, that's one of the differences that was posed in your hypothetical was that with respect to a competitive vendor, you either have to buy his equipment or you take it under a lease subject to purchase. Whereas, on a VTPP contract with Mountain Bell, you don't have the option of purchasing.

Q. Okay, Doctor, you've characterized the taking, if you will, or the entry into an agreement with Bell for a period of years for a particular piece of terminal equipment on a lease basis as a "lock-in." I understand the basis of that opinion to be your definition that lockin is an economic commitment. I think those were your words. If one were to lease a piece of equipment from Rolm or Executone, wouldn't that also be an economic commitment?

A. Oh, there would definitely be an economic commitment, and the distinction in that sense is that the one economic commitment has built into it the possibility of

reversal or changing your mind at some time in the future with a less severe economic penalty than the alternative commitment.

Q. That depends, does it not, on the terms of the agreement with the inventory vendor?

A. Well, it would depend upon the term of the agreement with the inventory vendor, but I'm somewhat familiar with the terms that are offered with respect to equipment leasing. And generally in the area of equipment leasing, the terms and conditions are not similar to the terms and conditions with respect to receiving service under an AT&T tariff. (Tr. pp. 1145-1147.)

In addressing the Applicant's argument that shorter initial lease lives under VTPP as compared to longer lease lives available under Two-Tier reduces the potential for lock-in, Dr. Wilson notes that

...it's not a situation in which Migration is intended to replace the long-term two-tier contracts with 4-year VTPP contracts. Keep in mind that even with the two-tier most customers chose contracts of around 5 years; they didn't chose the 10- to 12-year time periods. But at any rate, the Migration strategy is aimed at the older equipment which is not currently tariffed under a Two-Tier arrangement, and you are right in suggesting that on the surface the lock-in is for a 4-year period. But because the Bell System has scheduled to bring out the ANTELOPE superswitch within the next 2 to 3 years, that will afford Mountain Bell or AT&T at that time to go back to the customers for whom they installed flagship vehicles now and say, well, we've got something that's even better than that DIMENSION system that you put in 2 or 3 years ago, we'll let you shift to this newer vintage equipment now without penalty, all you have to do is enter into a new 4-year contract with us. So that's what I'm suggesting by the probability of rollover and this thing is carefully choreographed at the AT&T level to blend the 4-year initial contract on the Flagship vehicle with the proposed and anticipated premature obsolescence that is going to occur for these Flagship vehicles within the next 3 years or so, so as to facilitate at that time a further Migration; that is, Migration from Flagship to ANTELOPE. Whereas, the Migration we are talking about now, the original Migration strategy is to get customers out of the pre-DIMENSION equipment, the pre-HORIZON equipment into DIMENSION and HORIZON at the present time and into these 4-year contracts. And it's aimed at customers who are not receiving service under such a contract at the present. (Tr., pp. 1142-1144.)

The Commission is persuaded by the comments of Dr. Wilson and Mr. Money to conclude that there are, indeed, elements of the Variable Term Payment Plan that serve to provide AT&T and its Operating Companies with an unjust and discriminatory competitive edge in the vending of terminal equipment. The problem becomes even more acute when considered in light of the fact that AT&T currently controls well over 80% of the presently installed market base in the area of terminal equipment (see Transcript p. 1447 and p. 1453). This Commission,

cognizant of the fact that VTPP has been implemented in other jurisdictions, feels that approval of the VTPP prior to deregulation and detariffing of terminal equipment offerings would serve only to insure greater protection of an already overly protected AT&T market base, thereby promoting forces contravening the established goal of robust competition.

A close examination of the proposed VTPP tariff and the associated rates and charges for DIMENSION and HORIZON products under various payment period options provides insight into the strategy underlying the Variable Term concept. As was pointed out during the course of cross-examination, the one-month leasing option for these products is escorted by an inordinately high monthly rate. (See, for example, the Transcript at pp. 1318, 1319, and 1467.) As was noted by Mr. Money, this rate is high enough to preclude the feasibility of this option by any customers other than those who require the use of a PBX system for only a few months. The remaining customers must opt for a longer payment period. The next shortest payment period is four years! (The Commission is skeptical about the lack of intermediate payment periods such as two or three years.) Should the customer desire to convert to a technologically superior system after the expiration of two years of his contract with AT&T he is faced with severe termination charges. (See Finding of Fact No. 8 for the termination charges associated with DIMENSION products. These charges for HORIZON products are even more severe.) As was pointed out by Mr. Money, however, these termination charges are waived when the customer elects to take AT&T equipment rather than the equipment of an alternative vendor. This element is clearly discriminatory and anti-competitive.

Competitive aspects aside, there are several other reasons for not accepting the VTPP as filed. As Mr. Reinking acknowledges, the language and terminology employed are not as clear as they could be. (Tr., p. 1418). Also, maintenance is "...contingent on availability of parts." The Commission interprets this to mean that subscribers may find themselves facing substantially reduced servicing obligations. This does not comport with the notion of effective regulation. Finally, the FCC has set March 1, 1982 as the date for switching AT&T's terminal equipment business over to a fully separate, unregulated and detariffed subsidiary. At that time terminal equipment will be free to be marketed under any plan deemed appropriate by the fully separate subsidiary. The Commission notes that this deadline, still on schedule, is less than six months away. In the interim, this Commission is compelled by the reasons set forth herein to deny Mountain Bell's application for authority to implement the Variable Term Payment Plan.

### CONCLUSIONS OF LAW

1. Applicant, Mountain States Telephone and Telegraph Company, is a corporation providing telephone and other communication services within the state of Montana and as such is a "public utility" within the meaning of Section 69-3-01, MCA.

2. The Montana Public Service Commission properly exercises jurisdiction over the Applicant's Montana operations pursuant to Title 69, Chapter 3, MCA.

### ORDER

1. The application of Mountain States Telephone and Telegraph Company, for approval of tariffs to implement the Variable Term Payment Plan in conjunction with DIMENSION and HORIZON product lines is hereby denied.

2. All motions and objections made by the parties in this docket which were not ruled upon by the Commission at the hearing or earlier in this order are hereby denied.

DONE and DATED this 21st day of September, 1981 by a vote of 5 – 0.  
BY ORDER OF THE MONTANA PUBLIC SERVICE COMMISSION.

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GORDON E. BOLLINGER, Chairman

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JOHN B. DRISCOLL, Commissioner

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HOWARD L. ELLIS, Commissioner

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CLYDE JARVIS, Commissioner

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THOMAS J. SCHNEIDER, Commissioner

ATTEST:

Madeline L. Cottrill  
Commission Secretary

(SEAL)

NOTE: You may be entitled to judicial review of the final decision in this matter. If no Motion for Reconsideration is filed, judicial review may be obtained by filing a petition for review within thirty (30) days from the service of this order. If a Motion for Reconsideration is filed, a Commission order is final for purpose of appeal upon the entry of a ruling on that motion, or upon the passage of ten (10) days following the filing of that motion. cf. the Montana Administrative Procedure Act, esp. Sec. 2-4-702, MCA; and Commission Rules of Practice and Procedure, esp. 38.2.4806 ARM.